



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND REGULATION

April 30, 1997

Mr. Thomas J. McCool  
Associate Director  
Financial Institutions and Markets Issues  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. McCool:

This is in response to the GAO's draft report on the Foreign Banking Organization Supervision Program ("FBO Program"). Many of the draft report's conclusions and recommendations relate to the Strength of Support Assessment ("SOSA") and its overall function and use, to date, in the FBO Program. We agree generally with the conclusions reached regarding the need for certain improvements in the content and use of the SOSA reports. In addition to our comments below, we have provided comments of a more technical nature on individual pages of the draft report.

While the GAO's efforts were directed principally toward a review of the SOSAs, it is appropriate at this point to emphasize that the SOSA is one of several tools in the FBO Program designed to assist bank supervisors in meeting the objectives of the program. In summary, the program objectives are to enable U.S. supervisory authorities to have a complete assessment of the U.S. operations of each FBO, to maintain an appropriate supervisory strategy for such operations, and to coordinate the supervisory process on an interagency basis.

The value of a SOSA is to provide bank supervisors with a measure regarding the ability of an FBO to support its U.S. operations, both financially and managerially. Toward that end, the SOSA is intended to provide a general framework for evaluating and assimilating significant financial and managerial information related to individual FBOs. Factors to be considered include a review of the FBO's financial condition and prospects, the system of supervision in the FBO's home country, the record of how the home country deals with problems in the banking system, likely sources of support for the FBO, and any transfer risk concerns. Also to be identified are any factors that raise questions about the ability of the FBO to maintain adequate internal controls and compliance procedures at its U.S. offices.

The Reserve Bank responsible for the SOSA analysis is expected to exercise discretion in deciding what information is provided in the analysis based on the individual circumstances of the FBO. Under present guidance, the SOSA is expected to address the following at a minimum: 1) executive summary, 2) overview of the FBO, 3) financial factors, 4) prospects, 5) home country support, 6) other assessment factors, and 7) supervisory implications of the assessment. Other than these general categories, there is no prescribed list of required information. Given that the initial SOSAs have already or are in the process of being completed, annual updates are expected to primarily address any material changes to the financial condition or operating environment of the FBO, or other specific issues deemed significant. Therefore, future SOSA reviews are likely to vary even more in terms of form and content.

As noted in the report, the Federal Reserve began implementation of the FBO Program on March 31, 1995, when it issued its initial guidance on the program. The program was intended to be implemented over a three to five year period, and we believe we will be able to meet this schedule. The GAO review was conducted as of the end of approximately the first year and a half of the program's existence.

Additional progress has been made in implementation of the FBO Program since completion of the GAO's review of program documentation. Many of the initial more time-consuming elements of the program (i.e., the development of the various products and related review and distribution processes) are well underway.<sup>1</sup> Because the program involved substantial cross-agency coordination and the creation of new analytical products, some implementation problems were to be expected. Our work going forward largely will be to concentrate on refining certain areas of the program to enhance its overall effectiveness, particularly in the areas of integration of the SOSA into examination planning, ensuring that appropriate linkages are established between all products in the program to promote the program's objectives, and ensuring a more risk-focused examination process.

To that end, the following steps have been/are being taken:

- o In late 1996, System staff commenced development of an FBO Program training seminar for examiners and in-house international supervision staff. While course segments will cover the various individual products generated under the FBO Program, emphasis will be placed on the

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<sup>1</sup> As of April 7, 1997, approximately 92 percent of SOSA reports had either been completed or were in draft form.

FBO Program as a process directed towards ensuring an appropriate supervisory strategy for the U.S. operations of each FBO, rather than the generation of discrete analytical products. Among other things, the seminar will place emphasis on creating a greater linkage between the SOSA review and the comprehensive examination planning process.

- o The Reserve Banks have been directed by Board staff to ensure that any changes that need to be made to the supervisory strategy for the U.S. operations of the FBO that arise from the SOSA analysis are presented in a separate supervisory implications section of the SOSA report. The SOSA is expected to include the specific implications for any examination plan of a SOSA ranking of C or lower or when an asterisk is included in the ranking.
- o Procedures have been developed in order to ensure that SOSA rankings are considered final only when they have been formally reviewed and approved by a committee headed by officials of the Board's international supervision function. This initiative is intended to ensure the consistency and completeness of SOSA analyses and the assignment of a ranking that is supported by the analysis.
- o As noted in the draft report, an automated system (the FBO Desktop) is being developed to more efficiently share information and to review FBO program products. The system is expected to help improve the timeliness of information. Timeliness of information will likely continue to be impaired to some degree, however, due to the fact that FBOs are required to file full financial statements with the Federal Reserve only on an annual basis, English translations of such filings are often not available until mid-year, and disclosure/transparency problems may continue to exist. However, SOSAs are designed to arrive at an intermediate term view of the organization rather than to focus on short term changes.

We appreciate the opportunity to provide comments on the draft report.

Sincerely,

A handwritten signature in black ink, appearing to read 'Richard Spillenkothen', with a large, stylized flourish extending from the end of the signature.

Richard Spillenkothen  
Director